

# Off the Curb

*Once given up for dead, the American Stock Exchange finds new life*

BY MICHAEL SANTOLI

**J**UST FOUR YEARS AGO, IT WOULD have been laughable to suggest that the American Stock Exchange could compete with the New York Stock Exchange, its vastly more powerful neighbor two blocks to the east. The Amex at the time was steadily losing company stock listings to Nasdaq, the electronic market which by then had thoroughly captured the business of trading the shares of budding young companies, a role that for decades had been the province of the Amex. The exchange was suffering public embarrassment over an experimental submarket it had created for tiny companies, some of which were under regulatory fire. The value of an Amex seat slipped during 1995 to \$140,000 from \$155,000 despite the bull market then gaining strength. Speculations on the ultimate demise of the Amex were a staple of the financial press.

But under Chairman Richard Syron, who took on the top Amex job in 1994 and is now departing, the exchange affectionately known as the Curb upgraded its listing standards, seized

bountiful opportunities in the burgeoning derivatives arena and in the process made the Amex into an attractive partner for the mighty Nasdaq. The last sale price of an Amex seat was a record \$665,000 on April 1, five months after its merger with Nasdaq's parent.

This qualifies as a stunning turnaround: A few years ago newspaper editors grumbled about wanting to cut out Amex quotes to save space; last year the Amex name was beamed to billions via a season-long sponsorship of pro football on TV. Now, the little exchange on Trinity Place is viewed as a vital element in the Nasdaq's vigorous competitive tussle with the NYSE.

Several changes in the securities industry made this transformation possible. For one, the pitched battle for new stock listings had evolved into a two-player race between the NYSE and Nasdaq, stripping the Amex of its status as a finishing school for stocks before graduation to the Big Board. This left the Amex, led by a chairman with fresh eyes, to pick other battles and create a new self-image.

Syron, a former Boston Fed president, says he recognized that it was pointless to compete as simply a "smaller New York Stock Exchange, but without the badge" of being the oldest and biggest.

The tremendous growth during this bull market of options trading and the proliferation of "structured products" like exchange-traded index funds played to the strengths of the Amex, which had always been flexible in adopting new financial products that the more conservative



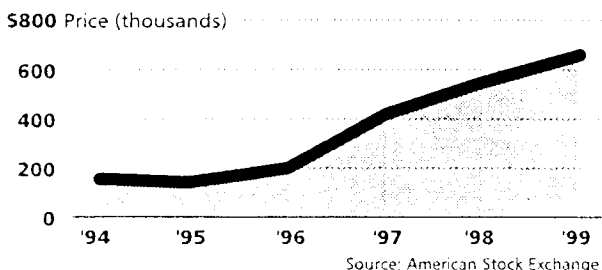
Turnaround team: Nasdaq's Richard Ketchum and Frank Zarb, above, and the Amex's Richard Syron



#### HOT SEAT

► Amex seat prices have quadrupled during Chairman Richard Syron's tenure, a sign of the exchange's revitalization and excitement about the Nasdaq merger.

#### ASE REGULAR SEAT PRICE



NYSE declined to touch. It was an early forum for options trading, beginning in the mid-'Seventies. And in 1993, the Amex launched trading in Standard & Poor's Depositary Receipts, known as Spyders, the phenomenally popular exchange-traded index fund that is the foundation for the Curb's leading franchise in the index-share business.

Meanwhile, Nasdaq's way of life had

theology of St. Nasdaq and the Amex preaching the gospel of the specialist."

Now the Nasdaq-Amex can be agnostic about which system an issuer chooses, just as GM doesn't much care whether a car buyer wants a manual or automatic transmission; it can offer what's best for the customer. In general, this means that for the biggest stocks the Nasdaq market-maker system is preferable, simply

because the amount of capital needed to turn over billions of dollars of stock a week can be supplied by numerous firms. For smaller or lower-volume stocks, the centralized order-routing of the specialist style probably is best to maximize liquidity and execution quality.

Looking ahead, the brass at Nasdaq-Amex have a handful of pressing priorities. One is to use the Nasdaq's deep pockets to upgrade technology across the board, lower trading costs, create new products and to usher in a new Amex floor-trading system. The Nasdaq's financial heft has already allowed the Amex to slash options-trading fees. The most notable evidence of the potential of the union is the launch last month of Nasdaq 100 index shares, a version of Spyders covering the top Nasdaq stocks that was an instant hit. At the end of March, the combined assets in all the index-share trusts run by the Amex stood at \$16.2 billion, double the year-earlier figure.

Soon, Nasdaq-Amex officials will be fanning out to companies listed on both their markets to help them determine whether a move from Nasdaq to Amex or vice versa makes sense for them. But that is a mere prelude to an aggressive future effort to poach listings from "our friends across the [Trinity Church] graveyard," as Syron calls the NYSE.

In recent years, the Big Board's focus has been, and remains to a large extent, on gaining huge-company listings from overseas, and it has succeeded in nabbing **Deutsche Telecom**, **DaimlerChrysler** and numerous others. But now the NYSE is becoming more aggressive in fishing for even smaller technology companies whose presumed home has been Nasdaq, not wanting to be left out of the dot.com economy. And the NYSE is a formidable competitor, boasting top-notch technology, vast resources, a prestige advantage and an enviable record of providing a fine pricing environment for its stocks.

This stepped-up recruitment activity by the NYSE comes as Nasdaq officials wage a crusade to bring down the Big Board's Rule 500, which makes it exceedingly difficult for a NYSE company to move elsewhere and is under fire by several constituencies. Says Zarb: "At some point, Rule 500 will go and a number of [NYSE companies] will say they can do better where **Microsoft**, **Intel** and **Starbucks** trade."

It remains to be seen whether many will make the switch. But even if not, its current prospects as part of Nasdaq-Amex show what a renaissance the Amex has enjoyed. Before he leaves June 1 to return to the Boston area as president of **Thermo-Electron**, Dick Syron could be forgiven if he took a victory lap around the old Curb floor. ■

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# BusinessWeek

APRIL 26, 1999

A PUBLICATION OF THE MCGRAW-HILL COMPANIES

## Jobs

Coping  
with a  
tight market



## Pointcast



The saga  
of an  
Internet  
blowup

## Russia

What happens  
when markets  
fail



## Autos

Family trucks,  
hot convertibles



# SCANDAL ON WALL STREET

In a six-month investigation, Business Week has uncovered major improprieties at **THE AMERICAN STOCK EXCHANGE.** The problems range from price-fixing in the options market to conflicts of interest by some specialists on the floor. Here's the inside story.



BY GARY WEISS

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### HIDDEN AMEX

The supposedly clean exchange has a dark side, rife with questionable trades and fixed prices page 96

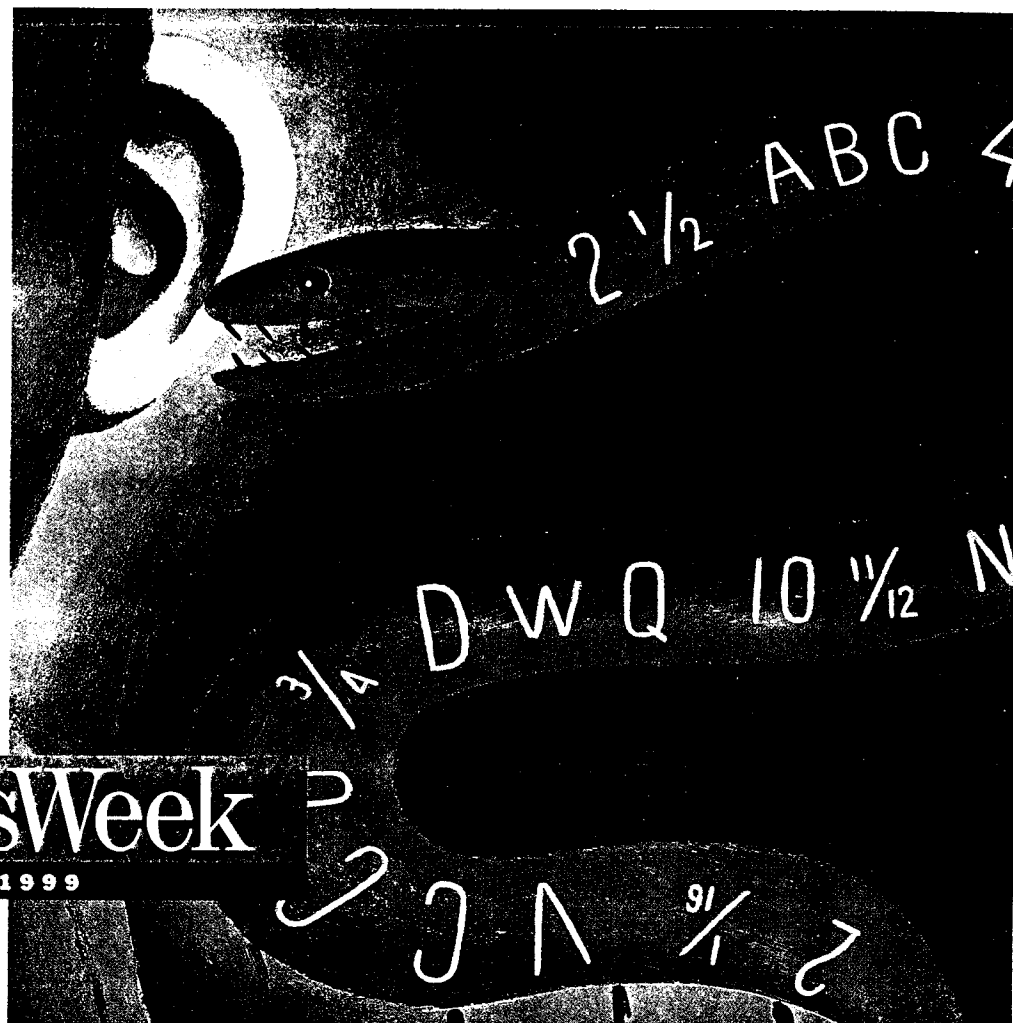


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Once a red-hot Net startup, PointCast is now on life support page 88

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APRIL 26, 1999



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The image of the traditionally quiet and clean American Stock Exchange has never been better. But outside the public eye, it's beset by price-fixing, conflicts of interest, and illegal trading—made possible by a climate of lax enforcement. A BUSINESS WEEK six-month investigation takes a look under the surface
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## THE AMERICAN STOCK EXCHANGE

# SCANDAL ON WALL STREET

BY GARY WEISS

In the April issue of the New York Stock Exchange monthly newsletter, Chairman Richard A. Grasso made a rare and embarrassing admission. The Securities & Exchange Commission had commenced an investigation at the NYSE. And the target was not a rogue broker, insider trader, or some other transgressor, but

rather the NYSE itself. Under scrutiny is a subject that could not have been more fundamental to the operations of the nation's premier stock exchange: Has the NYSE adequately regulated the brokers who execute trades on the exchange floor?

With word of the SEC probe, the scandal scorecard for U.S. stock markets became a decisive, and apparently definitive, score of 2-1: two stock markets tarred by scandals at the millennium's close, and one untouched for the greater part of two decades. The NYSE, which pledged cooperation with the

SEC, has had to cope with the aftermath of a federal court indictment last year alleging improper trading by floor brokers. Its archrival, NASDAQ, has been bruised by incessant micro-cap scandals and by accusations, in lawsuits and in an SEC report, that NASDAQ market makers were conspiring to fix prices. The exception, the apparent island of relative tranquility, was that venerable Wall Street institution, the American Stock Exchange.

**NO PROBES.** To be sure, the Amex has had its troubles—notably a longtime weakness in luring and holding top-notch equity listings. Five years ago, it wrestled with concerns about the quality of some of the smaller companies listing on the exchange. And the Amex is in transition. In a few weeks, the exchange will be losing its chief executive officer, respected economist Richard F. Syron, and it has entered a potentially rocky partnership with NASDAQ. But the Amex brings to the merger a fast-growing options business and something the NASDAQ is striving to attain—a reputation for integrity that is second to none. Amex officials note with pride that its floor membership has not been subject to a single criminal indictment or major SEC investigation since the late 1970s. As Syron takes his leave, the Amex's public image has never been better. "Before he leaves June 1," *Barron's* observes in its Apr. 12 issue, "Dick Syron could be forgiven if he took a victory lap around the old Curb floor."

But on the "old Curb floor," not everyone feels much like cheering. For there is another Amex that has remained in the background—and is considerably darker than the one in the public eye. This Amex was the subject of a six-month investigation by *BUSINESS WEEK*. And what emerged was, in its own way, more troublesome than the difficulties encountered by its two competitors. Unlike the scandals that rocked NASDAQ and the NYSE in recent years, the troubles that have

### FALL FROM GRACE?

The Amex's clean, wallflower image conceals a climate rife with fear of retribution

beset the Amex have had absolutely no publicity. But they have not been secret by a long shot. For the difficulties besetting the Amex have taken place under the noses of the Amex officials charged with enforcing the rules of conduct on the Amex floor.

BUSINESS WEEK interviewed traders, floor brokers, specialists, and clerks, as well as current and former Amex officials and current and former federal and local regulators. We also reviewed thousands of pages of documents, most not publicly available. What emerged was a multifaceted, often complex story with but one common theme: The American Stock Exchange has failed to adequately police itself. It is a failing that seems most vividly apparent when its most powerful and influential firms and personalities are involved.

The key findings:

- Amex options specialists and traders are said to regularly engage in price-fixing. The aim is to keep as wide as possible the "spread" between the bid—what the public can get to sell an option—and the ask, which is what the public must pay to buy an option. Because the prices are allegedly skewed to favor the denizens of the Amex floor, the public is hurt each year, BUSINESS WEEK estimates, to the tune of \$150 million. The Amex denies knowledge of improper options pricing (page 99).

- Amex sources maintain that a host of other trading improprieties are commonplace. Chief among these are what they describe as illegal trading by floor brokers and specialists, similar to the accusations in the indictments of the NYSE floor brokers. But Amex officials say that there is no broad SEC inquiry—of the kind just announced at the NYSE—into how the Amex regulates its floor personnel.

- With the SEC's tacit concurrence, the Amex routinely doles out light punishment when it uncovers wrongdoing on the floor. In contrast to its merger partners at NASDAQ, who work closely with the SEC and federal and state prosecutors, the Amex deals with most allegations of even serious wrongdoing "in the family" (page 108).
- The American Stock Exchange's scandal-free reputation is a mirage. Since 1995, the Amex floor has been rocked by a major floor-trading scandal involving alleged improper trading by Pasquale Schettino, a top official of its most powerful specialist firm, Spear, Leads & Kellogg. The Amex apparently did not follow up on testimony indicating knowledge and approval of Schettino's activities by top Spear officials—including its former senior partner, Peter R. Kellogg. Spear and Kellogg, who were not charged by the Amex, declined to comment, as did Schettino's lawyer (page 102).

- Allegations have been made regarding another influential force on the Amex floor, specialist Joseph Giamanco, who heads the specialist firm GHM Inc. Persons familiar with Giamanco's operations maintain that he has, for years, traded for his personal profit in stocks of companies in which his firm specializes. If so, that would be a serious violation of exchange rules and would fall afoul of the federal securities laws if nonpublic information was exploited. Giamanco's attorney denies that the veteran specialist has committed wrongdoing (page 104).

- Specialists are permitted by the Amex to obtain cut-rate "cheap" stock in publicly traded, chiefly micro-cap compa-

nies. This practice—which is legal and sanctioned by the exchange—raises the danger that companies may give influential Amex specialists cheap stock to get their support for listing company stock on the Amex.

- The Amex, the SEC, and law enforcement have failed to adequately investigate numerous allegations of improprieties at the Amex that were made in recent years by an options trader turned whistle-blower, Edward R. Manfredonia (page 110). The Amex maintains that Manfredonia's allegations were investigated and dismissed as without merit, and the SEC says his letters were forwarded to the appropriate officials. But officials privately concede that little weight was given to his allegations—important aspects of which were substantiated by BUSINESS WEEK's investigation.

**PROBLEMS FIXED.** To be sure, none of the Amex's hidden troubles necessarily overshadow the many positive developments at the Amex in recent years, particularly since the appointment of Syron, its chairman since 1994, who previously was CEO of the Federal Reserve Bank of Boston. There's no denying that the Amex has made headway against its nagging problems—lagging listings and weak equity trading volume. In recent weeks, the Amex lost its largest stock listing—Viacom, which accounted for some 4% of all volume on the floor of the exchange. But for every such problem in recent years, there has been a solution in the form of a new product—such as its series of well-received index-linked equities based on the Standard & Poor's 500-stock index. The S&P index products are issued under an agreement with The McGraw-Hill Companies, which publishes BUSINESS WEEK and owns S&P.

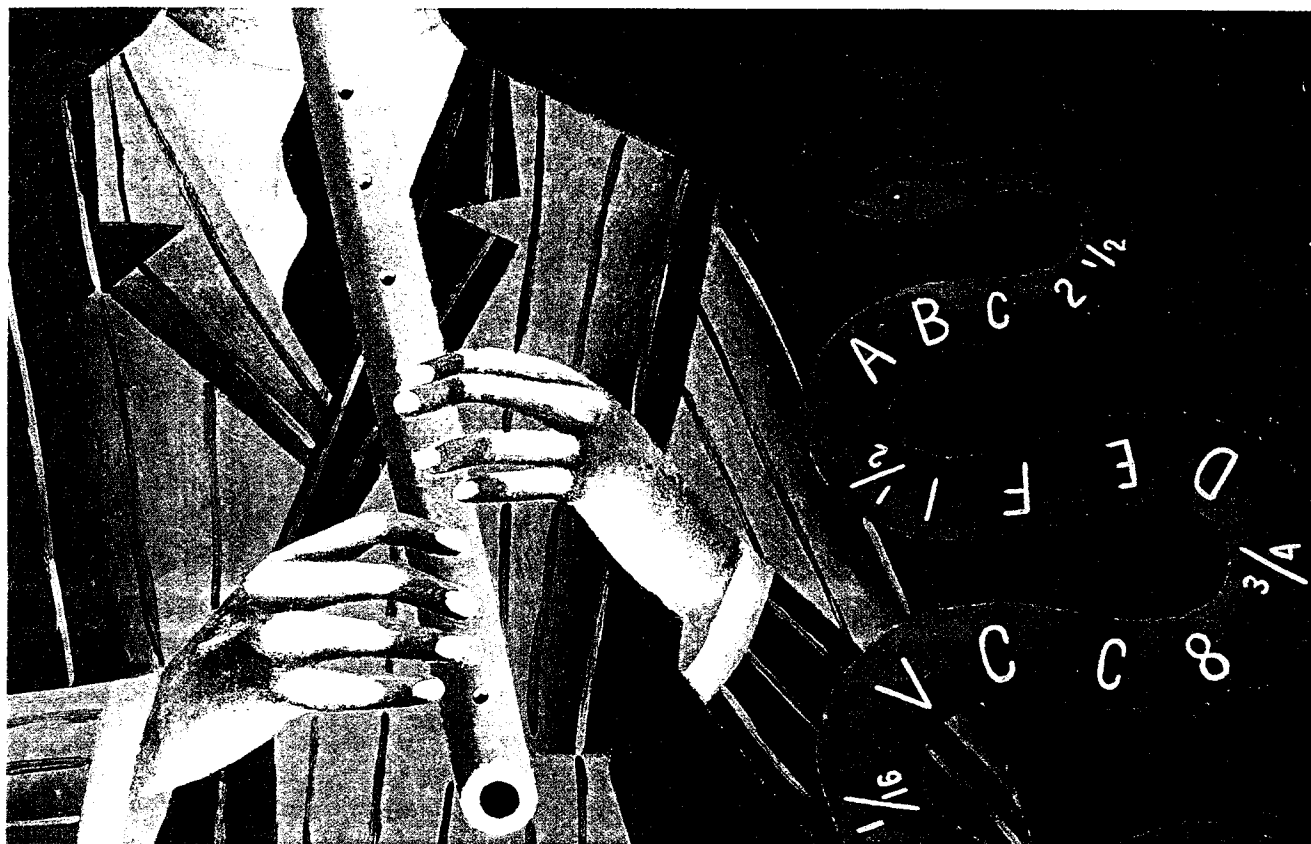
In an interview with BUSINESS WEEK, Syron vigorously defended the Amex's record as a regulator. He expressed surprise and concern about the allegations concerning the options market—but also dismissed them as routine grousing. "I think over the last several years...there's always room for improvement, but [we have done] a pretty good job here in the regulatory climate at the Amex," asserts Syron. Another high Amex official, speaking privately to BUSINESS WEEK, also expressed surprise at the allegations and the hope that floor personnel would bring any allegations of improprieties to his attention.

But on the floor of the exchange, such sentiments would be viewed with disdain. Indeed, the brokerage officials and Amex floor personnel, current and former, of all levels of seniority, who were interviewed by BUSINESS WEEK did so on condition of confidentiality—in the belief that their livelihoods would be ruined if they were known to be talking to the press.

For the National Association of Securities Dealers, which now runs both NASDAQ and the Amex, the implications of the Amex's hidden troubles are serious. The Amex will continue to regulate itself despite the merger, albeit under the NASD's general aegis, because the merger leaves intact the Amex's enforcement and surveillance apparatus. But what becomes of a corporate culture that, people on the floor maintain, turns a blind eye to improper conduct?

In the articles that follow, BUSINESS WEEK examines in detail the scandals that have simmered under the surface of the American Stock Exchange. □

*Price-fixing, illegal trading, and cover-ups are among the more serious charges. The lack of policing may be the most worrisome*



# Price-fixing, the Amex way

*Two-tier pricing can  
guarantee a tidy profit*

Options have never been more crucial for the American Stock Exchange. In the first quarter of 1999, the Amex reported a 30% growth in options volume over the year before—vs. a mere 5% gain in stock-trading volume. But beneath the cheery statistics is one of the dirty little secrets of the Amex floor: two-tiered options pricing that, as described by people familiar with the practice, amounts to a form of price-fixing.

Early this year, the U.S. Justice Dept. initiated an anti-trust investigation into how options are traded at all four ma-

for options exchanges, and nine class actions alleging anticompetitive practices were filed against the exchanges in federal court in Manhattan. The Chicago Board of Options declined comment, and the Pacific Exchange pledged cooperation with the probe.

The investigation was sparked by the exchanges' reluctance to list options already listed by other exchanges. Critics have long maintained that this practice keeps customers from getting the best possible prices. That may be so. But current and former Amex floor personnel point to another, more direct reason.

**BIG MONEY.** According to these sources, investors often pay too much when they buy an option and get too little when they sell. It means they put in "limit orders"—orders specifying prices—based on incorrect information. If just one-tenth of options trades, now about 120 million a year, are skewed against the public by merely an eighth of a point, investors are hurt to the tune of \$150 million a year.

Here's how Amex options price-fixing is said to work: **The specialist establishes the option's publicly quoted price.**

Specialists are traders who buy and sell options but with special responsibilities—and power. And that includes the power to establish the prices that appear on trading screens

## DIFFERENT TUNES

The alleged price-fixing may cost nonpro investors \$150 million a year

## WHY ARE THESE OPTIONS SPREADS SO WIDE?

Recent bid-ask spreads of widely traded Amex options on Apr. 12

COMPANY	TYPE OF OPTION	BID	ASK	SPREAD
AMAZON.COM	APRIL '99 190 CALLS	4%	5	8%
BELLSOUTH	APRIL '99 42½ CALLS	2	2½	13
ELI LILLY	APRIL '99 85 CALLS	5½	5½	10
INTEL	APRIL '99 55 CALLS	6½	6½	8
LUCENT	APRIL '99 52½ CALLS	6½	7½	7

COMPANY	TYPE OF OPTION	BID	ASK	SPREAD
MERRILL LYNCH	APRIL '99 95 CALLS	5¼	5¼	10%
MOTOROLA	APRIL '99 80 CALLS	2½½	2½½	9
PFIZER	APRIL '99 145 CALLS	5½	5½	7
PHILIP MORRIS	APRIL '99 35 CALLS	1½	1½	18

DATA: BLOOMBERG FINANCIAL MARKETS

worldwide. Prices of both stocks and options are expressed by two numbers—a "bid" and an "ask." The bid price is the price a member of the public can get when selling an option. The ask price, which is higher, is the price an investor will have to pay when buying the option. The difference between the bid and ask is the "spread."

At the same time the specialist establishes the official bid-ask prices of the option—the prices disseminated on trading screens—the options market makers establish their own price, often with narrower spreads.

In the example described on this page, based on the recent pricing of a widely traded option, the trader was able to offer a spread of 4%—versus the 8% spread set by the specialist. Market-maker firms frequently can meet their expenses, and turn a handsome profit, while offering more modest spreads to traders on the floor. By offering better prices, they can draw business from professional investors who use floor brokers to negotiate better prices.

Ordinary investors pay the prices set by the specialists—and not the better prices available from the market makers.

That's because they don't know that better prices—narrower spreads—are available. The trading screens show the wider bid-ask spreads set by the specialists. Floor traders can insist that specialists display their better prices on the trading screens. But they don't. One reason is fear. As one trader points out, "it is well known that specialists don't like it"—and can retaliate by excluding traders from getting a share of large trades that come in to the floor. But fear is not the only reason traders don't insist.

Traders and specialists alike benefit from wide spreads. "Market orders"—at the prevailing bid-ask price—are usual-

ly executed at the prevailing bid-ask spread set by the specialists. And investors base their limit orders on the same artificially wide bid-ask spreads. One trader notes that the growth of automatic execution of trades means that more and more trading is at prices set by the specialists.

There are exceptions to the dual-pricing scheme. The vast majority of Amex options are very thinly traded. For such options, the bid-ask

spreads quoted by everybody—specialists and traders alike—are wide. But the practice is described by floor sources as an everyday occurrence for more widely traded options. "All the public sees is that their trade is executed instantly. They have no idea what's going on," says one trader.

How widespread is this practice? Well, the class actions, filed in early February in the wake of the anti-trust probe, allege that improperly wide spreads and price-fixing occur on all four options exchanges because of their supposed "conspiracy" against multiple listings. Each of the suits contends that market makers and specialists "agreed not to compete by seeking to offer narrower spreads."

But at the largest options exchange, the CBOE, the form of price-fixing allegedly occurring at the Amex seems less likely. At the CBOE, market makers shout at each other to compete for business, in

this fashion exchanging bid-ask quotes that are written down by exchange employees and then shown on trading screens. By contrast, at the Amex, prices are set by the specialists, and floor price "reporters" do not play the active role of their counterparts at the CBOE.

Resolving this problem would require a change in the way prices are reported—which SEC Chairman Arthur Levitt Jr. proposed in a letter to the options exchanges on Feb. 10. He

## HOW THE TWO-TIER SYSTEM HURTS THE PUBLIC

### THE SMALL INVESTOR

10:00 A.M.

#### A small investor places an order

An investor wants to buy ten options contracts in XYZ Corp. The price, per contract, on the trading screen is 6 bid, 6½ ask. That means investors who buy options at the "market" pay \$650 per contract and if they want to sell that option they get \$600. The investor puts in a "market order" at the prevailing price or a "limit order" at 6½. He assumes that is the best price available for investors who want to buy.

10:01 A.M.

#### The order is automatically executed...

The investor's brokerage, to save money, does not use floor brokers. Instead, the order is automatically routed to the option's specialist post on the Amex floor, via the exchange's Auto-Ex order-execution system.

10:01 A.M.

#### ...at a bad price

Seconds later, the order is automatically executed by the specialist, or a trader on the floor, at the price on the screen—6½. The investor pays \$6,500, plus commissions.

#### Meanwhile...

A professional trader is buying the exact same option at a lower price.

DATA: BUSINESS WEEK

### THE PRO

10:00 A.M.

#### A professional investor places an order

A professional investor places an order to buy 10 contracts in the same option. The bid-ask prices on the screen are the same prices seen by the small investor—6 bid, 6½ ask.

10:02 A.M.

#### The floor broker announces the order

The pro uses a brokerage firm that employs an experienced floor broker. The broker walks to the specialist post on the Amex floor and announces he wants to buy 10 contracts in the option.

10:02 A.M.

#### A market maker takes the order

A trader in the "crowd" at the post consults his pricing data—not publicly available—and sees that his firm's market in the option is 6½ bid, 6¾ ask. He tells that to the floor broker.

10:02 A.M.

#### The order is executed—at a better price

The floor broker buys the 10 contracts for the pro at 6¾, or \$6,375, plus commissions. The better price offered by the market maker—6¾ bid, 6¾ ask—is not reported on the trading screen, which shows that the price for this option is still 6 bid, 6½ ask.



observed: "It is now feasible for each competing market maker to publish its own quote"—an innovation that would do away with any two-tiered pricing at the exchanges, the Amex included. With that proposal, Levitt appeared to acknowledge at least the potential for discriminatory pricing at the exchanges.

Amex Chairman Richard F. Syron expressed surprise and chagrin when told of the alleged two-tier pricing. Syron says even the most informal price-fixing arrangements are simply not acceptable at the exchange. "That would be wrong. That should not happen.... There can't be tacit agreements," Syron, however, does not believe the allegations. "It is not at all infrequent to have one group [the traders] complaining about the other group [the specialists]," he says.

Syron believes that such allegations underscore—rather than undermine—the importance of the system of self-regulatory organizations. "The reason you have SROs is, these things are so complex that the only people who really understand all of the details of this *in toto* are the people who are there, engaged in it, on a moment-to-moment basis," says Syron. The complexity and speed of the options market, he notes, point up "the degree of responsibility and the importance of SROs doing a good job."

That's precisely the point. But just how well does the Amex regulate itself? If the allegations concerning options pricing have any validity, they indicate a deep malaise—one that permeates the Amex. □

## A Double Life at Spear Leeds?

*The Amex may have dragged its feet investigating Pat Schettino*

Until his last day on the floor of the American Stock Exchange, in the fall of 1998, Pasquale "Pat" Schettino was one of the most powerful people on the Amex floor. For years, he held a key position at Spear, Leeds & Kellogg, the largest specialist firm at both the Amex and the New York Stock Exchange. On the Amex, Schettino was in charge of "professional clearing," meaning that he rode herd over the 300 specialists, traders, and floor brokers who have accounts at Spear. If "Spear Leeds is the Amex," as one veteran trader puts it, Schettino was Spear Leeds.

With that power came access to immensely sensitive information. For many of his final years at the Amex, Schettino was a Spear managing director and partner. And that gave him access to a trove of trading data—inside information showing Spear's positions in the hundreds of stocks and options it traded as a specialist.

Schettino's position of trust and power went well beyond his role at Spear Leeds. In 1992 and 1993, and again from 1994 through 1996, he was a "floor official"—one of the 60 or so Amex traders and specialists who are the first line of defense in the self-regulatory system. But according to a small mountain of documentation in the files of the American Stock Exchange—none of which has been made public—Pat Schettino allegedly had intimate, first-hand knowledge of a whole range of things traders and floor brokers and specialists are not supposed to do.

**MAJOR TRADER?** As outlined in still-unreleased Amex charges filed in November, 1996, against Schettino—charges that remain unresolved after nearly two and a half years—the 50-year-old Staten Island resident led a double life. At the same time that he was the top Spear official on the exchange floor, he allegedly violated Amex rules by having a major role at a now-defunct trading firm on the Amex floor called Bullseye Securities Inc., which cleared its trades through Spear. He

### COVERT ACTION

The Amex says Schettino traded at a small firm while running Spear floor operations



allegedly hired and fired traders, "provided investment advice and trading instruction"—and, above all, allegedly traded as if it was going out of style. As set forth in the Amex charges, this is what he did from January, 1994, to July, 1995:

- Traded in some 130 stocks and options for Bullseye, up to 1.3 million shares a month. Among them were 40 stocks and an unspecified number of options in which Spear was the specialist, including Digital Equipment Corp. and Intel Corp. options
- Made fictitious trades to bolster Bullseye's net capital levels
- Opened an account at Bullseye to allow a floor broker to improperly trade for the broker's own profit
- Made a covert loan to Bullseye, passing the money through the bank account of a friend
- Opened an account in the name of a fictitious person

- Made false statements in sworn testimony before an exchange official
- Diverted money to Bullseye from two floor brokers—and allegedly altered a Spear account statement to mislead one of the brokers into thinking the money went to Spear after all.

Neither Spear, Schettino's attorney Eric R. Levine, nor the Amex would comment on the case. In his answer to the charges, Levine denied Schettino ever traded on nonpublic information. He conceded that Schettino traded for Bullseye but said it was "for no personal gain" and as a favor to Bullseye owner Joseph Roffler—which Roffler has emphatically denied.

Some of the allegations against Schettino are as grave as the allegations made in the indictments of eight NYSE floor

charges. But the Schettino case seemed unusually protracted—raising the possibility that the Amex dragged its feet to put off resolution of a potentially explosive case. The case emerged in July, 1995. Charges were not brought against Schettino until 16 months later and were only acted upon by an Amex panel about two years after that, in the fall of 1998. Schettino appealed, and that, too, has not been resolved after half a year. Because the Amex does not announce disciplinary actions until final action, the Schettino case remains under wraps—as it has been for almost four years. Indeed, no documentation from the Schettino case would have emerged were it not for a libel suit Schettino brought against a whistle-blower, Edward R. Manfredonia (page 110), and Bullseye owner Roffler, as well as an arbitration brought against Spear Leeds and Schettino by Roffler.

**Did the Amex disregard evidence that Spear Leeds officials—including senior partner Peter R. Kellogg—knew and approved of Schettino's activities?**

Spear Leeds was not charged by the Amex, even for failure to supervise Schettino. In its charges against Schettino, the Amex cleared the powerful firm, saying that at no time before July, 1995, had Spear been "aware of, or approved, Schettino's trading for accounts at Bullseye." But testimony before the Amex and other accounts of Schettino's activities obtained by BUSINESS WEEK indicate that Spear knew of and appears to have condoned Schettino's conduct—and that the Amex was aware of that and failed to penalize Spear.

Schettino's trading for Bullseye was an open secret on the Amex floor, where Spear is a dominant presence. "He'd just walk up to the specialist booths and put in orders," says one former Bullseye trader. "That was the amazing part. He'd just do it, and nobody would question him." According to testimony received by the Amex, Schettino's role at Bullseye was known to Spear officials, including a supervising specialist charged with improperly having a Bullseye account and two officials in charge of margin lending. In addition, Bullseye principal Roffler—a former Spear managing director—has told friends that a Spear Leeds senior specialist on the Amex floor, Arthur Rafkind, was aware of Schettino's trading. Roffler and Spear general counsel Carl H. Hewitt declined comment, and Rafkind denied that he had been aware of Schettino's trading.

Even more damaging evidence against Spear came from Schettino himself. In his February, 1996, testimony before an Amex enforcement official, Schettino recounted an August, 1995, conversation between himself and Spear counsel Hewitt. According to Schettino, Hewitt said that an Amex official "asked to have me removed from the exchange." Schettino testified that Hewitt said that "[Spear senior partner] Peter Kellogg said, 'No, we are not going to remove him from the Exchange. He hasn't done anything that we feel was anything bad.'" Kellogg and Hewitt both declined comment.

Spear's actions also indicate that the firm's management did not find fault with Schettino's conduct—even after it was revealed and the Amex probe was under way. When the Bullseye allegations emerged in July, 1995, Schettino was retained in his job on the floor—after, according to Schettino, Spear rebuffed the Amex' request to remove him. He remained managing director and partner until December, 1995—five months after the scandal surfaced. Spear kept him on the Amex floor until the fall of 1998, removing him only when a



brokers last year. And elements in his case have troubling implications for the Amex, which declined to discuss any aspect of the Schettino affair: BUSINESS WEEK examined thousands of pages of never-released testimony and trading records in the Schettino case. Among the questions they raise:

**Did the Amex deliberately delay resolving this case?**

The Amex often takes several years to resolve disciplinary

*Both Spear Leeds and people on the floor appear to have known of Schettino's irregularities*

disciplinary panel imposed a permanent bar—a decision that, like the charges, has never been made public.

**Did the Amex conduct an adequate investigation?**

The scandal was apparently much wider—and more embarrassing for Spear and the Amex—than has been portrayed even in the Amex' closed-door proceedings. According to persons with first-hand knowledge of his activities, Schettino secretly traded for and backed yet another trading firm, Viking Securities LP, even after he was charged by the Amex. Schettino's involvement was alleged in a letter that was sent in mid-1997 by Viking's risk manager, Gene Weissman, to Viking's clearing agent, Sage Clearing.

In the letter, Weissman maintained that Schettino told him on June 6, 1997, that "he is the 'backer' of Viking Securities through a subordinated loan agreement under another name." The letter was addressed to a Sage senior vice-president, C. Curtis Richmond. Richmond did not return phone calls. Weissman, who has not been contacted by investigators, declined comment, saying: "I'm not going to admit or deny I had any type of correspondence with any clearing firm, or anything like that."

**Did the Amex fail to refer the Schettino case to prosecutors to spare Spear—and itself—an embarrassing scandal?**

According to persons close to Bullseye and Viking, including essential witnesses in any probe, there has been no Securities & Exchange Commission or law-enforcement investigation of Bullseye or Viking since the scandal erupted nearly four years ago—even though the whistle-blower, Manfredonia, wrote a series of letters calling the case to the attention of authorities.

One former New York law-enforcement official, not contacted by Manfredonia regarding Schettino, expressed surprise when told of the case—which he had never heard of, even though it arose on his watch. He observed that the charges brought against Schettino by the Amex appeared similar to the kinds of allegations that had been the subject of criminal prosecutions of microcap scamsters—including falsification of business records, false testimony, and fictitious trades. "That is the kind of case that I would think you'd want to take criminally," he notes.

But a former high Amex official says that such a referral to prosecutors would have been unlikely at the Amex because of Spear Leeds's clout. "That could be where the politics come into play," he adds. Amex Chairman and CEO Richard F. Syron scoffs at the assertion that Spear was given any special treatment by the Amex. While declining to comment on the Schettino case, because it is still ongoing, Syron was more willing than Spear Leeds itself to defend the firm. He noted that "they're a pretty big, successful company, and I'd be surprised—I don't see what their motivation would be" to approve of Schettino's activities at Bullseye. Says Syron: "I don't think Spear Leeds has been treated any differently than anyone else down here." □

## Cover Story

SCANDAL ON WALL STREET

# Did a Specialist Break the Rules?

*A honcho at GHM may have traded covertly*



A Philadelphia-based company by the name of Hemispherx Bio-pharma Inc. is the center of the perennial struggle between "longs," who favor its stock, and "shorts," who wager on the shares' decline. But there has been an intriguing, covert element to the often dreary Hemispherx controversy—one unknown to longs and shorts alike.

At issue is GHM Inc., the specialist in charge of trading in Hemispherx stock. According to current and former associates intimately familiar with his activities, the head of GHM, Joseph Giamanco, has for years traded for his own profit in shares of stocks in which his firm specializes—including Hemispherx. He stopped only recently, these people say.

These are grave allegations. As a specialist firm, GHM has a duty to make a "fair and orderly market" in stocks traded on the floor of the Amex. Specialists have unique access to order-flow information via the "limit order book," which shows outstanding orders to purchase the stock at a specific price. Thus, Amex and New York Stock Exchange rules prohibit

### THE REGULATOR

Giamanco, as a floor official, is bound to enforce rules he allegedly broke

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SCANDAL ON WALL STREET

specialists from short-term trading for their personal profit in the stocks in which their firms are specialists. If non-public information is used, such trades could violate federal securities laws.

Responding to questions from BUSINESS WEEK regarding Giamanco, his attorney, Gary Naftalis, released a statement that did not directly respond to the allegations. It noted that "Mr. Giamanco is a respected member of the American Stock Exchange who enjoys a well-earned reputation for integrity in all of his business dealings. He has fully complied with all applicable regulations and rules."

The 53-year-old Giamanco is surely one of the most prominent specialists at the exchange. When the Amex appointed a "blue ribbon" panel in 1991 to select companies for its Emerging Company Marketplace of small companies, Giamanco was one of the "venture-capital and growth-company experts" selected. Indeed, Giamanco's prestige in recent years has grown to the point that he—and his partner Ronald Menello—have become floor officials, charged with enforcing securities rules on the exchange floor.

But it is just those rules that Giamanco is alleged to have violated. One longtime former employee maintains that Giamanco's trading was widely known among Giamanco's employees and that Giamanco would "move money out of the company" into a trading account that he covertly owned and controlled—something that apparently caused some animosity among the people who worked for him. "Then they tell you how broke they are," says one former employee.

According to these sources, Giamanco traded for "upstairs" accounts—off the Amex floor—using names other than his own. A current Giamanco associate says that the trading in Hemispherx ended only recently. The identity of other stocks in which Giamanco allegedly traded could not be determined.

**WINDFALL.** Another connection between Giamanco and Hemispherx is also troubling, though it is perfectly legal. For years, he has been a recipient of lucrative private-placement shares, beginning in November, 1995, when the company was brought public by Stratton Oakmont Inc., the notorious penny-stock firm. While the terms of all the private placements could not be determined, at least one was extremely profitable for Giamanco.

According to SEC filings, in March, 1997, Giamanco was among a small group of people allowed to purchase preferred stock in Hemispherx. Giamanco purchased 275 preferred shares at a cost of \$1,000 each, or \$275,000. Each was convertible into 500 shares of common stock, meaning that Giamanco's preferred stake translated into 137,500 shares of Hemispherx common stock, at a cost of \$2 a share. In addition to Giamanco, his close friend Joseph Roselle received the convertible preferred shares—in Roselle's case, convertible to 25,000 shares of Hemispherx—all in the months before Giamanco's firm was selected by Hemispherx to be its specialist on the Amex floor. Efforts to reach Roselle, whose phone number is unlisted, were unsuccessful.

Giamanco's purchase proved propitious. In October, 1997, Hemispherx was listed on the Amex—and selected Giamanco's GHM as its specialist unit. The company's shares were trading at \$4 by the end of 1997. During 1998, Hemispherx shares—

traded out of Giamanco's post on the main trading floor of the Amex—traded at an average price of \$5.50 a share, rising to as high as \$12 and never falling under \$2.75 a share. Thus, Giamanco's preferred-stock windfall is likely to have reaped him a gain of more than \$400,000, while his friend Roselle would have received a smaller chunk of change, perhaps \$75,000 or so.

As time went on, Giamanco and Roselle's holdings in private-issue stock swelled—and other Giamanco associates joined in. A February, 1998, SEC filing registered for sale yet another 110,000 shares for Giamanco and 240,000 more for Roselle. It also registered shares for Giamanco's partners, 10,000 for Menello and 40,000 for Gary Herman. Many of these were shares underlying convertible securities. The degree to which the four men stood to profit, if at all, from the private placements was unclear from SEC filings. Calls to Hemispherx Chief Financial Officer Robert E. Peterson were not returned. Menello declined comment on his stake in Hemispherx, and Herman did not return phone calls.

**FULL DISCLOSURE?** According to SEC filings, Roselle recently participated in the private placement of two other companies in which GHM is a specialist: Fortune Natural Resources Corp. and Trinitech Systems Inc. A Fortune attorney said the company was not involved in Roselle obtaining the shares,

and Trinitech Chief Executive Peter Hansen said he was unacquainted with Roselle. Roselle also joined Giamanco in obtaining private-issue shares in three other small companies, including one whose shares trade on the OTC Bulletin Board, Automotive Performance Group Inc.

The presence of Giamanco, Roselle, and Herman in the Automotive filings is intriguing. According to the December, 1998, SEC filing registering the shares, Automotive disclosed that it had

filed for listing on the Amex. But Automotive's income statement shows that it does not appear to meet Amex listing guidelines, because of operating losses. Does the involvement of Giamanco, his partner, and his friend bode well for Automotive's overcoming these obstacles? Automotive, at least, is silent on the subject. Its top executives did not return phone calls.

Giamanco is not the only specialist to receive shares in a company prior to being named as a specialist. Another beneficiary was Spear, Leeds & Kellogg, which, along with Giamanco, recently was included in the private placement of a company called Endorex Corp.—not long before the firm selected Spear as its Amex specialist.

Amex Chairman Richard F. Syron says that there is nothing wrong with specialists' participating in often lucrative private placements by companies in which they later become specialists—so long as the exchange knows about it. "These guys, they're independent businessmen, they're entrepreneurs, they're risk-takers," notes Syron. He notes that they may take a stake in a company before it goes public "and naturally, as it gets to the stage of becoming public, they'd have an interest in where it trades." He sees nothing wrong there—as long as the exchange is informed. But the Amex did not respond to queries on whether it was, in fact, informed.

Other people familiar with the Amex are not so sanguine and believe that Giamanco may be getting the benefit of the doubt for a questionable practice. They note that he has

*The practice of buying shares in a company, then advising that the Amex list it, raises the specter of conflict of interest*

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SCANDAL ON WALL STREET

been actively involved in recruiting OTC and NASDAQ companies for the Amex. One former Amex official who had compliance responsibilities expressed surprise at learning of Amex specialists' obtaining private-issue shares prior to becoming specialists in those companies' shares. "I don't recall it being commonplace at all," he asserts. "Yet it appears to be somewhat commonplace now."

**APPARENTLY LEGAL.** Another former regulator agrees that the practice, while legal, is dubious. "I'm pretty surprised that the American would allow you to have accumulated a position" in cheap stock, he observes. The practice is troubling for several reasons. For one thing, an Amex listing holds considerable cachet for small, micro-cap companies, particularly OTC Bulletin Board stocks. Specialists play a major role in recruiting small companies to the Amex and in recommending that such listings be accepted. A grant of cut-rate stock to Amex specialists can have the appearance of being an inducement to get a stock listed. That question arises from the

Giamanco involvement in Automotive Performance.

But at the Amex, potential conflicts of interest such as this are overshadowed by even more serious issues. There is, for example, the stance of the American Stock Exchange and law enforcement toward Giamanco. As was the case with Pasquale "Pat" Schettino (page 102), the Amex whistle-blower Edward R. Manfredonia wrote numerous letters to the SEC and the U.S. Attorney's office in Manhattan alleging that Giamanco had been trading shares for his own benefit. A spokesman for the U.S. Attorney declined comment, citing office policy, and an SEC spokesman said that the charges were taken seriously. But Giamanco's attorney Naftalis says he knows of no SEC or law-enforcement probe of his client—and floor sources concur.

All this raises yet another discomfiting question. If the Amex is not demonstrating sufficient will to police itself vigorously, are other regulators, or law enforcement, taking up the slack? □



## The Flaws in Self-Policing

*Both the Amex and the feds turned a blind eye to big trouble*

**LIGHT TOUCH**  
In December, 1997, an Amex disciplinary panel alleged that a specialist named Sol Reischer made phony options trades to benefit the firm he works for, Joseph Giamanco's GHM Inc. Reischer, who declined comment on the case, paid a \$35,000 fine, neither admitting nor denying the charges. As is usual in such instances, Reischer's alleged transgression received no publicity. For all intents and purposes, it was a nonevent.

Twenty years before, nine Amex specialists were accused of the same alleged offense as Reischer—phony options trades. They allegedly performed those trades not for profit but for

Time and time again, the Amex has punished offenders with a slap on the wrist

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### SCANDAL ON WALL STREET

the innocuous purpose of bringing thinly traded options in line with the prices of more actively traded ones. But the penalty was dramatically different. The nine were indicted by a New York grand jury in a widely publicized case. The specialists settled the charges without admitting or denying wrongdoing.

Similar allegations, two dramatically different responses. Whichever was the more appropriate, this much is for sure:

Time and again, when alleged transgressors are penalized by the Amex, they are let go with a fine or a brief suspension. And that routinely happens for the same magnitude of wrongdoing that led to indictments at the Amex in 1978 and again last year at the New York Stock Exchange. Amex officials feel they have been tough, however. "If you ask people on the floor, I think a lot of them would tell you that we're Attila the Hun," says Amex Chairman Richard F. Syron.

Asked for a specific instance of a tough penalty, Amex officials cite a decision released in 1996 involving the punishment of alleged improper trading by AGS Specialist Partners, run, they note, by Amex Governor Andrew Schwarz. Without admitting or denying the allegations, the firm agreed to penalties that included a \$75,000 fine and suspension of one of its specialists for six months. But an Amex disciplinary committee—without being asked, says Schwarz—cut the fine to \$50,000 and the suspension to three months, calling them "too severe." Schwarz says the public was not hurt by his firm and the penalties imposed were tough. But did his status as a governor affect the panel's decision? "I would like to think that it didn't, but I think it's possible," he concedes.

**NO PROBLEM.** Syron defends the Amex' commitment to rooting out transgressors. Amex officials note that the Amex has suspended three specialists and nine traders within the past three years. Syron and other Amex officials say that the Amex' vigilance has long passed muster with the SEC and now with the Amex' new owners, the National Association of Securities Dealers Inc. At no time, he says, have the SEC or NASD indicated that they have any problem with the Amex as a regulator. "I think [the SEC] would tell that there's been a real uptrend in how we handle regulation."

But SEC and NASD officials are mum on the subject. NASD Regulation Chief Executive Mary L. Schapiro declined comment on the Amex' track record as a regulator, as did SEC enforcement chief Richard Walker and the SEC official in charge of overseeing enforcement activities at the Amex, Lori Richards. Still, the SEC's inaction at the Amex speaks for itself. Although the Amex is a self-regulatory organization, it operates under the scrutiny of the SEC. And there is troubling evidence that, time and again, the SEC has disregarded allegations of trouble on the exchange floor.

A good example can be found in the case of Amex specialist Giamanco, who is described by persons with knowledge of his activities as allegedly trading in GHM Inc. stocks for his own benefit (page 104). Amex whistle-blower Edward R. Manfredonia sent, by certified mail, no fewer than 50 letters to

the SEC and law enforcement from September, 1995, to August, 1998, maintaining that Giamanco was engaged in such conduct. "We do take any kind of claims of purported fraud seriously," says an SEC spokesman, adding that letters of that kind were referred to Richards. However, Manfredonia says he was never contacted for additional information, and people close to Giamanco say that no SEC inquiry has taken place.

Likewise, Manfredonia told SEC officials and law enforcement of Pasquale "Pat" Schettino's alleged involvement in Viking Securities (page 102). Again, the allegations were substantiated by BUSINESS WEEK. But officials of Viking and Bullseye Securities Inc., the other firm in which Schettino was involved, were never contacted by regulators.

Recipients of Manfredonia's many letters note that their volume and often overwrought tone undercut his credibility. But such excuses are unconvincing. The malaise at the Amex has persisted too long to go unnoticed.

Indeed, the true flaw

may lie at the very heart of the system of self-regulation at the Amex. The evidence is clear that the exchange has been too insular, too secretive, and too intent on protecting the status quo. However, the exchange's new owners at the NASD have an impressive track record for cleaning up their own

### NOT CONCERNED

Amex President Syron says the SEC is happy with the exchange's self-regulation

house and may well be ready to do the same for their new partners. There is an old Chinese proverb: "The laws sometimes sleep, but never die." At the American Stock Exchange, the laws have been slumbering for a very long time. □



## The Gadfly of Trinity Place

*Edward Manfredonia has been crying in the Amex wilderness*

His friends had warned him to stay away. But on Feb. 9, 1999, Edward R. Manfredonia decided to take a chance. For the first time in eight years, he walked through the front door of 86 Trinity Place, headquarters of the American Stock Exchange Inc., and asked to use the library on the fifth floor.

The Amex library is open to the public. Anybody who



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### SCANDAL ON WALL STREET

walks in off the street can just drop by and use it without even calling ahead. The visitor standing directly behind Manfredonia had no trouble getting a visitor's pass to use the library. But not Manfredonia. After waiting 20 minutes, the answer came down from an Amex manager: No. Manfredonia could use the library only if he were accompanied by a security guard, who would watch him while he was there. No one was available to keep an eye on him, so he had to leave. "They let all kinds into this building," said one of the guards. "I don't see why you should be the exception."

But the real reason was made plain in the lobby of the Amex building. While Manfredonia was kept waiting, a trader on the floor of the exchange came by and said hello. Then another. And then others. Some were merely acquaintances. But others were contacts who had provided Manfredonia, at considerable risk to themselves, sensitive information about the inner workings of the exchange.

**VOCAL THORN.** That is what makes the diminutive, 51-year-old Manfredonia *persona non grata* at the American Stock Exchange. For the past eight years he has become a familiar figure in the vicinity of the Amex building. Talking to people. And then going home and writing letters. This former Amex trader works full-time with one aim in mind—to ferret out wrongdoing on the American Stock Exchange and pass it on to anyone who will listen.

Amex Chairman Richard F. Syron says that Manfredonia has made "wild" accusations and that the volume and extreme tone of his letters have hurt his credibility. And other Amex officials had little to say about Manfredonia on the record, though privately they sought to discredit him. But some Amex members privately take a far different view. "Over the past couple of months, we've talked about a whole bunch of subjects, and I've taken a liking to the guy," says one former high Amex official. "I think he's trying to do what he thinks is right and deal with things he thinks were unfair."

Manfredonia first came to the Amex floor as a clerk in the early 1980s and then worked his way up to trader in 1984. Occasionally he would quietly go to the media with tips. In 1988 it came to his attention that certain brokerages were involved in "index front-running"—trying to make a killing in index options by manipulating the price of the underlying index. Manfredonia learned his first lesson as a whistle-blower—some people just don't want to listen. One prominent financial journalist "wanted trading records, which was just impossible. When I couldn't get them, he lost interest," he recalls.

Manfredonia became a permanent, vocal thorn in the side of the exchange after disturbing information came his way in 1989 and 1990. He learned that employees of a specialist firm, run by a highly placed figure at the exchange, had al-

legedly been sexually assaulted by the official. The women would not come forward—but Manfredonia did, in complaints

to the authorities that, evidently, did not endear him to exchange officials. A year later he was fired from the now-defunct trading firm that employed him at the time—at the behest of the Amex, he insists, for "spreading rumors."

Manfredonia says he was blackballed—barred from employment with any firm doing business on the exchange. He has been unemployed since leaving the Amex floor, subsisting on savings and help from friends—and spending a good part of his time fighting the Amex, and losing. Manfredonia has writ-

ten hundreds of letters to regulators, law enforcement, and the media, leaving him with little more than piles of green certified-mail receipts. "We are well aware of the information you've given us, and we are in fact looking into it," one prominent newspaper executive assured Manfredonia back in 1993 after getting a series of letters about alleged transgressions at the Amex. "We know how to reach you," the exec continued, "and there's no need to keep sending letters." Manfredonia stopped sending letters—and the newspaper, he notes ruefully, did nothing.

Among the subjects of his letters was former Spear, Leeds & Kellogg Managing Director Pasquale "Pat" Schettino (page 102). Manfredonia

wrote letters to, among others, officials of companies whose stocks were allegedly traded by Schettino. That led to a libel suit by Schettino. Manfredonia, who is struggling to fight the case without an attorney, says the suit was an effort to silence him and force him to reveal his contacts. He maintains the suit

was inspired by the Amex, which the exchange's head of member-firm regulation, Stephen Lister, vigorously denies. Schettino's attorney, Eric Levine, declined comment on the suit.

Manfredonia's letter-writing campaign has hardly been an example of effective business communication. His letters are often filled with trading-floor jargon and accusations in screaming-headline boldface. "We got letters. I think we looked into it or referred to it to someone else. I didn't give it much merit or credibility. I never really looked into his allegations," says one former regulator who has received letters from Manfredonia. "That's the problem with whistle-blowers. They may have a very meritorious claim, but they don't convey it well."

Manfredonia has become a figure of fun, sometimes openly taunted by Amex traders and clerks. But one thing is certain. Regulators and law enforcement cannot claim that they could not have known what's been going on at the American Stock Exchange. Ed Manfredonia has been telling them for years. □



#### SILENCED VOICE?

Manfredonia claims a libel suit by Schettino is an attempt to shut him up

## INVESTIGATIONS

# THE AMEX IS STARTING TO FEEL THE HEAT

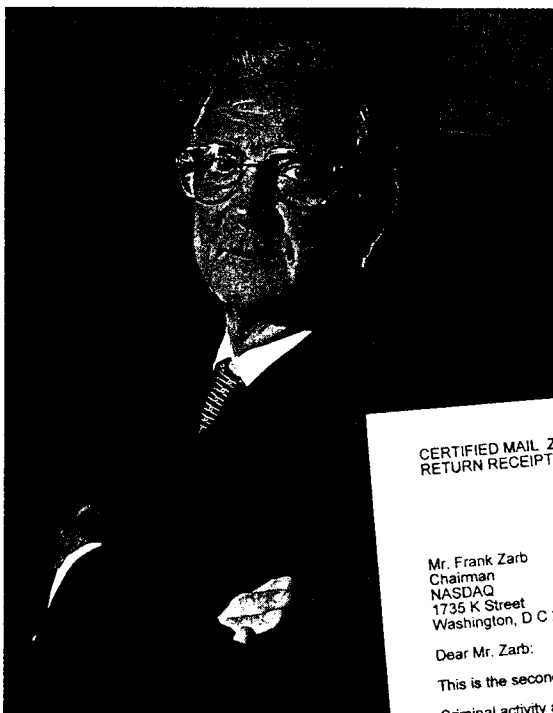
A new lawsuit alleges price-fixing in its options market

On Mar. 16, 1998, Edward R. Manfredonia wrote a 10-page letter to Frank G. Zarb, chief executive of the National Association of Securities Dealers. Word was just out that the NASD was planning to merge with the American Stock Exchange. Manfredonia, a trader turned whistle-blower, wanted Zarb to know about what he alleged was a pattern of illegal activity at the Amex. The outcome: Nothing. No one at the NASD contacted him.

Well, Zarb and other regulators are starting to pay more attention to allegations about the Amex. In a statement on Apr. 16, the Amex' new overlord pledged to "follow up all claims of improper activity in any of our marketplaces." The reason for the sudden change in attitude was simple: Zarb was reacting to a BUSINESS WEEK Cover Story that hit newsstands that day. The article reported allegations of widespread misconduct at the Amex, including improper trading, price-fixing in the options market—and lax enforcement by the Amex. BUSINESS WEEK also found that the Securities & Exchange Commission and law enforcement failed to investigate Manfredonia's allegations, important aspects of which were substantiated by BUSINESS WEEK.

The Amex may have no choice but to finally confront its problems—if only because the lawsuits have begun. On Apr. 16, two of the Amex' largest specialist firms—Spear, Leeds & Kellogg and Susquehanna Investment Group Inc.—were named in a class action alleging options price-fixing. The suit was filed in Federal District Court in Manhattan by the four lead law firms in an antitrust case alleging price collusion by NASDAQ market-makers. That case has resulted in \$1 billion in settlements.

The Amex case alleges that Spear, Susquehanna, and other unnamed defendants violated the federal antitrust laws through a "conspiracy to raise, fix, and maintain" the bid-ask spreads of Amex options at artificially high levels. "They have combined to create a two-tier market, apparently, and are operat-



**CHANGE OF ATTITUDE:** NASD chief Zarb is now all ears to allegations of wrongdoing at the Amex

ing it for their benefit and to the detriment of the general trading public," says Robert A. Skirnick, one of the lawyers bringing the suit. Spear declined comment, and Susquehanna's general counsel did not return phone calls.

Zarb's statement did not directly address dual-pricing and said that the "options pricing matter is an industrywide issue." However, as described by Amex sources, the alleged Amex price-fixing stems from the trading system at the exchange—with market-makers offering narrower spreads than specialists who set the prices. Thus it would be

more difficult to implement at the "open outcry" system used by the other major options trading center, the Chicago Board Options Exchange.

In the end, all the allegations surrounding the Amex will have to be sorted out by the SEC, which for years has demonstrated a hands-off attitude. On Mar. 26, the SEC sent a letter to all four options exchanges, asking for information on options pricing and bid-ask spreads, as well as documents reflecting possible collusion by market-makers. The SEC request, however, was an "informal inquiry," not an investigation.

**NO CONTACT.** If the SEC acts on options pricing, it will be a changed approach. Officials of the new NASDAQ-Amex Market Group—including Amex Chairman Richard F. Syron—say that the SEC has long expressed satisfaction with the Amex' record as a regulator. Contrary to a report in *The Wall Street Journal*, officials deny that any broader investigation of the Amex has begun. Indeed, persons with firsthand knowledge of Amex floor scandals say that they have never been contacted by the SEC.

For that matter, Amex whistle-blower Manfredonia says he did not even get replies to most of his letters. The only outcome of his letters was a libel suit by a former Spear Leeds managing

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RETURN RECEIPT REQUESTED

Mr. Frank Zarb  
Chairman  
NASDAQ  
1735 K Street  
Washington, D C 20006

Dear Mr. Zarb:

This is the second letter concerning criminal activity at the AMEX.

Criminal activity at the American Stock Exchange is pandemic. I therefore, wish to outline in brief summary some of the criminal activity at the AMEX. The first examples shall involve the utilization of the Disciplinary Decisions of the American Stock Exchange (AMEX). The second list of crimes perpetrated at the AMEX shall be stated by me. These crimes are in many cases of greater magnitude than those crimes for which AMEX members have been disciplined. I wish you understand that ev-

Edward Manfredonia

16 March 1998

director, Pasquale Schettino, who has been accused by the Amex of a long list of improper acts. Schettino has denied wrongdoing. Late in 1995, Schettino sued Manfredonia for libel because of some letters Manfredonia had written.

But Schettino has had second thoughts about his libel suit over the past few days. On Apr. 20, he abruptly agreed to dismiss the suit. It was, for Manfredonia, the end of a legal nightmare. But for the Amex and its most powerful firms, the bad dreams may be only just beginning.

By Gary Weiss in New York